

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

LOUIS C. PAVENTY

CASE NO. 97-67284

Debtor

TRUAX & HOVEY, LTD. AND C & R
SUPPLY, INC.

Plaintiffs

vs.

ADV. PRO. NO. 98-70102A

LOUIS C. PAVENTY

Defendant

APPEARANCES:

ADORANTE, TURNER & MYERS, P.C.
Attorneys for Plaintiffs
5111 West Genesee St.
P.O. Box 600
Camillus, New York 13031-0600

ANTHONY P. ADORANTE, ESQ.
Of Counsel

WHITELAW & FANGIO
Attorney for Defendant
247-259 W. Fayette St.
Syracuse, New York 13202

MARY LANNON FANGIO, ESQ.
Of Counsel

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The Court has before it a motion for summary judgment filed on October 1, 1998, on behalf of Truax & Hovey, Ltd. ("Truax") and C&R Supply, Inc. ("C&R") (hereinafter jointly referred to as "Plaintiffs") in connection with an adversary proceeding commenced by the filing

of a complaint on March 12, 1998.¹ Issue was joined by the filing of an answer on behalf of Louis C. Paventy (“Debtor”) on April 7, 1998. Plaintiffs seek a declaration that the debt allegedly owed to them by the Debtor is nondischargeable pursuant to § 523(a)(4) of the Bankruptcy Code (11 U.S.C. §§ 101-1330) (“Code”).

The motion was originally scheduled to be heard in Syracuse, New York, on October 20, 1998, but was adjourned as a result of a cross-motion for summary judgment filed by the Debtor on October 14, 1998, seeking a determination that the Debtor has no fiduciary duty to the Plaintiffs as trustee under Article 3-A of the New York Lien Law (“Article 3-A” or “NYLL”). Oral argument on both motions was heard on November 3, 1998, and the matter was submitted for decision that day.²

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of the adversary proceeding pursuant to 28 U.S.C. §§ 1334, 157(a), (b)(1) and (b)(2)(I).

¹ Plaintiffs are described as “sister companies” based on the two having “essentially the same directors, owners and officers.” *See* Plaintiff’s Memorandum of Law, filed October 30, 1998, at 8.

² The trial, which originally had been scheduled for September 14, 1998, was adjourned on consent of the parties to November 9, 1998. The trial was again adjourned and has not been placed back on the Court’s trial calendar pending the decision herein.

FACTS

Debtor alleges that in the spring of 1995 L&D Development Co., Inc. (“L&D”), of which Debtor serves as president, entered into a contract with Truax for the purchase of Lot 145, Brittany Hills, Onondaga, New York (“Real Property”), for \$40,000. The deed to the Real Property was held in escrow by Debtor’s attorney, Robert Temple, Esq. (“Temple”), and, according to Temple, was not to be released until both Truax, as the title holder of the Real Property, and the materialmen working on construction of a residence thereon had been paid. *See* Affidavit of Temple, sworn to October 8, 1998, at ¶ 5.

Debtor acknowledges that the Plaintiffs provided materials for the improvement of the Real Property prior to the closing on it. On November 29, 1995, the Debtor received \$114,000 from James J. Delmonico (“Delmonico”) pursuant to a Note and Mortgage, secured by the Real Property (“Delmonico Mortgage”), which was executed by the Debtor on behalf of L&D and recorded in the Onondaga County Clerk’s office on December 1, 1995, at 9:30 a.m. *See* Exhibit “C” of Plaintiffs’ Motion. According to the terms of the Delmonico Mortgage the Real Property was to be improved by a single family house. The document also provides that it was a “purchase money mortgage.”

With respect to the proceeds of the loan made to L&D by Delmonico, the “Register Listing” for the “L&D Lot 145” account for the period between November 29, 1995 and December 6, 1995 reflects a deposit of \$114,000 on November 29, 1995. It also identifies various checks that were written on December 6, 1995, after which a balance of \$50.32 remained in the account. Included in those checks were the following:

Check #1617	- Louis Paventy	\$ 1,000
Check #1620	- Charles Schafer, Esq. Tully Building Supply	\$36,011.33
Check #1622	- Temple & Temple	\$ 7,009.58
Check #1626 ³	- Truax & Hovey	\$39,701.45
Check #1635	- L&D Land Development Al Pope & Sanders Concrete	\$ 2,400

Richard D. Hovey (“Hovey”), Plaintiffs’ president, acknowledges that at some point prior to the closing on the sale of the Real Property to L&D, the Debtor informed him that although ready to close on that sale of the Real Property, it would probably be another 60 days before the Debtor/L&D would be able to close on the sale of the Real Property to the ultimate buyer. *See* Letter of February 20, 1997, attached to Temple’s Affidavit. According to Hovey, the Debtor also indicated that he would like to secure the debt owed with respect to the labor and materials owed to C&R and Truax on the house with a mortgage to be paid at the time of the latter closing. *Id.* On December 1, 1995, the Debtor, on behalf of L&D, executed a mortgage on the Real Property, which had been drafted by Plaintiffs’ attorneys, in favor of C&R in the amount of \$25,152.65,⁴ which was recorded on December 1, 1995, at 3:00 p.m. in the Onondaga County Clerk’s office (“C&R Mortgage”).

ARGUMENTS

Plaintiffs contend that having provided labor and materials in connection with the

³ Check #1626 was used to pay off the balance owed in connection with the purchase of the Real Property from Truax.

⁴ This amount represents the monies due Truax and C&R for the labor and materials provided with respect to the improvements of the Real Property.

improvement of the Real Property, they are beneficiaries of the monies loaned to Debtor by Delmonico pursuant to Article 3-A. It is the Plaintiffs' position that the fact that they accepted a mortgage to secure the debt owed them did not constitute a waiver of their rights as trust fund beneficiaries.

The Debtor argues that Truax was the owner of the Real Property at the time the improvements were made. Debtor contends that the cost of improvements made by an owner of real property may not be the subject of a lien under Article 3-A. Debtor acknowledges that C&R "could have been a beneficiary but accepted a mortgage instead on the Real Property" to secure the debt owed to C&R.⁵

DISCUSSION

[T]he primary purpose underlying the enactment of Article 3-A [of the New York Lien Law] was to ensure that laborers and materialmen were paid from the project funds by making the owner or the contractor a trustee for the benefit of subcontractors and others"

Northland Associates v. I.R.S., 160 B.R. 484, 493 (N.D.N.Y. 1993) (citation omitted); *see also* *Canron Corp v. City of New York*, 89 N.Y.2d 147, 155, 674 N.E.2d 1117, 652 N.Y.S.2d 211 (N.Y. 1996) (stating that the purpose of the Lien Law is to "ensure that 'those who have directly expended labor and materials to improve real property . . . at the direction of the owner or a general contractor' receive payment for the work actually performed." (citations omitted)).

The Debtor executed the Delmonico Mortgage on behalf of L&D as its president. Neither

⁵ The amount of the mortgage represents monies owed to both Plaintiffs. Allegedly, Truax assigned its claim against the Debtor to C&R for purposes of the mortgage.

party appears to dispute that the monies received by the Debtor on behalf of L&D from Delmonico constituted trust funds. As president of L&D, the Debtor has a fiduciary duty to the beneficiaries of the trust (“Trust”) and will be held personally liable for any breach of trust. *See Atlas Bldg. Systems, Inc. v. Rende*, 236 A.D.2d 494, 495, 653 N.Y.S.2d 694 (N.Y. App. Div. 1997) (citations omitted). The only questions before the Court are whether Truax was a beneficiary of the Trust and whether C&R, as well as Truax if found to be a beneficiary, waived any rights in the Trust by executing the C&R Mortgage in the amount of their claims for labor and materials.

NYLL §2(3) defines “owner” to include “a vendee under a contract for the purchase of such real property.” Under the facts set forth by the parties, L&D was the “owner” of the Real property at the time the Plaintiffs rendered services in connection with improvements to the Real Property despite the fact that the deed was being held in escrow by Debtor’s attorney and legal title had not been transferred. Yet, the Debtor argues that Truax, as vendor, also had liability for the costs associated with the improvements to the Real Property. Relying on *M&B Plumbing & Heating Co, Inc. v. Cammarota*, 103 A.D.2d 879, 472 N.Y.S.2d 901 (N.Y. App. Div. 1984), the Debtor contends that at the time the improvements were made to the Real Property Truax was liable for any costs because it held legal title to the Real Property at that time and, therefore, could not be a beneficiary. Indeed, the court in *M&B* did find that because the improvements had been made with the knowledge of the vendor under an installment land contract, the vendor was liable for the costs arising as a result of the improvements made on the real property. However, the facts of *M&B* are easily distinguishable from the matter presently before the Court.

In that case, the vendee was in possession of the property and with the knowledge of the

vendor/landlord made certain improvements on the property pursuant to the contract which were to be regarded as rent. As a result of the vendee's default in payments under the installment land contract, the vendor took steps to recover possession of the real property and ultimately foreclosed on the property. The court found that the work performed, including "enhancing the operation of the heating system of the facility," benefitted the vendor's interest in the property and, accordingly, found the owner/vendor liable to the subcontractors. *See id.* at 880, 472 N.Y.S.2d at 903.

In this case, any benefit Truax might have received as a result of the improvements to the real property never materialized once it was actually sold to L&D for the agreed upon purchase price.⁶ Contemporaneous with the transfer of legal title to the Real Property to L&D, the trust res was created as a result of the loan from Delmonico. Having made improvements to the Real Property, Truax became a beneficiary of the Trust.

It follows that the Court needs to focus its attention on whether Plaintiffs waived their rights as beneficiaries when the C&R Mortgage on the Real Property was executed, thereby securing their claim of \$25,752.65 for labor and materials.⁷ As noted above at Footnote 6, Plaintiffs' claim for labor and materials was secured by the Real Property which comprised a portion of the Trust assets. The execution of the mortgage did not change the fact that the

⁶ A portion of the monies received from Delmonico were used to purchase the Real Property from Truax. While this is not a use of trust funds enumerated in Article 3-A, the courts view the transaction not as a diversion of trust assets but as a conversion from a liquid asset to real property. *See RSJ Construction Corp. v. General Contracting Corp.*, 142 Misc.2d 126, 128, 536 N.Y.S.2d 398, 399-400 (NY. Sup. 1989).

⁷ Apparently, Truax assigned its claim against the Debtor to C&R for purposes of the mortgage which identified only C&R as the mortgagee. Neither party disputes that the \$25,752.65 includes costs associated with the labor and materials of both Plaintiffs.

Plaintiffs had rights to payment for their services as trust beneficiaries.

Therefore, the Court concludes that the Plaintiffs have standing, as beneficiaries of the Trust, to bring an action pursuant to Code § 523(a)(4), seeking a determination that the debt owed them by the Debtor is nondischargeable. The fact that a Trust was created and the Plaintiffs have been determined to be beneficiaries of it is insufficient to allow the Court to grant them such relief. They still have the burden of proving that the debt arose as a result of the Debtor's fraud or defalcation while acting in a fiduciary capacity. *See In re Tripp*, 189 B.R. 29, 35 (Bankr. N.D.N.Y. 1995). In this regard, there are material facts which are disputed and need to be addressed at trial.

Based on the foregoing, it is hereby

ORDERED that the Plaintiffs' motion seeking summary judgment is partially granted to the extent that the Court has determined that they are beneficiaries of the Trust, but is otherwise denied; it is further

ORDERED that the Debtor's cross-motion seeking summary judgment is denied; and it is finally

ORDERED that the adversary proceeding shall be rescheduled for trial commencing at 1:00 p.m. on February 8, 1999, at the U.S. Courthouse, 10 Broad Street, Room 236, Utica, New York.

Dated at Utica, New York

this 23rd day of December 1998

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge